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No. 214.

214 IN THE Supreme Court of the United States

October Term, 1949.

UNITED STATES OF AMERICA, Petitioner

versus

CUMBERLAND PUBLIC SERVICE COMPANY,
a Corporation

On Petition for a Writ of Certiorari to the United States Court of Claims.

BRIEF FOR RESPONDENT IN OPPOSITION.

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WESTERFIELD-BONTE CO., INCORPORATED, LOUISVILLE, KY.

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OPINION BELOW.

The special findings of fact and opinion of the Court of Claims (R. 55-76), together with the dissenting opinion of Judge Madden (R. 76-77), are reported at 83 F. Supp. 843.

JURISDICTION.

The judgment of the Court of Claims was entered on May 2, 1949 (R. 77). The jurisdiction of this Court is invoked under Title 28 U. S. C., Section 1255 (1).

THE QUESTION PRESENTED BY THE PETITION.

The real question before the Court at this time is whether the Government is to be accorded in this Court special privileges which are not accorded to citizens and taxpayers—whether the Government may obtain a writ of certiorari more or less as a matter of course, upon grounds which do not suffice in the case of citizens and taxpayers and upon grounds which on more than one occasion this Court, *at the Government's instance,* has held to be insufficient.

Commissioner v. *Court Holding Company,* 324 U. S. 331, was decided by this Court on March 12, 1945. Since that time there have been numerous decisions of the Tax Court, the District Courts, the Courts of Appeal, and the Court of Claims in somewhat similar cases, each one decided in the light of *Court Holding Company* and the particular facts presented.

The Government has not heretofore asserted in this Court that these decisions are in conflict or that they present "an issue of considerable importance in the administration of the income tax law," as the Government now asserts.

In two of these cases, the taxpayer filed a petition for a writ of certiorari upon similar grounds and in both cases the Government represented to this Court that no important question was involved and that the decision in each case rested upon its own particular facts. *Fairfield S. S. Corp.* v. *Commissioner,* 157 F. 2d 321, certiorari denied November 12, 1946, 329 U. S. 774; and *Benjamin Guinness* v. *United States,* 73 F. Supp. 119, certiorari denied May 17, 1948, 334 U. S. 819.

Although not embodied in any rule of court, the view has sometimes been expressed that the Government's petition for certiorari in a tax case should be accorded greater weight than that of a taxpayer—this upon the theory that the Government, in the handling of a multitude of cases, is in better position to judge the importance of clarifying the law than is the taxpayer who is presumably concerned only with his own immediate problem. Whether or not there is legal justification for such a proposition under ordinary circumstances, there can certainly be none in this case. The Government has twice represented to this Court that there was no occasion to review decisions in similar cases where the taxpayer sought certiorari on the same grounds.

THE QUESTION PRESENTED ON THE MERITS.

The respondent does not agree that the question presented in this case has been accurately stated by the Solicitor General in the petition herein.

The owners of all of the outstanding shares of capital stock of Cumberland Public Service Company entered into negotiations looking to the sale of their stock. These negotiations continued over a period of several months and an offer in the sum of $86,750 was received, it being the understanding of the stockholders that this was an offer for the purchase of their stock. Subsequently it was disclosed that the proposed purchaser could not legally acquire stock in a corporation, but could legally acquire physical assets. At this point the proposed purchaser for the first time made an offer in

the sum of $104,000 directly to the corporation for the physical assets desired by the purchaser. The corporation considered this offer and unqualifiedly rejected it. At the same time, the stockholders, acting through two of their number who agreed to serve as agents for all, undertook to acquire designated physical assets as a dividend in kind, in liquidation of the corporation, and offered to sell these assets for $104,000. This offer was accepted by the purchaser, the corporation was duly dissolved, the transfer as a liquidating dividend was duly made, and the stockholders then made the sale.

The corporation did not negotiate for the sale of the physical assets and the only offer received by the corporation was the result of the stockholders' negotiations for the sale of their stock.

The question presented on the merits is not whether the process described was effective to relieve the corporation from tax liability, as the Government asserts, but whether any tax liability accrued to the corporation in the first place as a result of the events disclosed by the findings of fact.

Since the Government's petition contains a rather extensive statement of the facts and since that statement is both inaccurate and incomplete, we feel obliged to submit our own counter-statement, which we believe fairly summarizes the findings of the Court of Claims. However, since the merits of the case are not germane to the issues presented at this time, we omit them here and supply them as Appendix B, accompanied by a very brief answer to the Government's irrelevant argument on the merits.

STATUTES AND REGULATIONS INVOLVED.

The pertinent statutes and regulations will be found in Appendix A.

ARGUMENT.

The Government advances three reasons for the granting of a writ of certiorari. These are:

(1) That the decision of the Court of Claims was wrong.

(2) That the present case raises an issue of "considerable importance in the administration of the income tax law."

(3) That the decision below conflicts in principle with *Commissioner* v. *Court Holding Company,* 324 U. S. 331, and with decisions of other courts rendered subsequent thereto.

The validity of all three reasons is here questioned. We will argue them briefly in the order in which they are set out above.

(1) The decision below is right. The Court of Claims did not assume that the ultimate question depends upon who appears to be the formal vendor of the property, as the Government asserts, and did not misinterpret *Court Holding Company.* We submit that the Government's attempt to argue the merits in its petition for a writ of certiorari is out of place, since this Court's Rule 38 does not list the correctness or incorrectness of a lower court's decision as a ground

for certiorari. Nevertheless, the Government's distortion of the facts and of the decision below make it appropriate for us to respond, and we do so in Appendix B.

(2) The Government's action in other cases decided since *Court Holding Company* belies the claim that this case raises "an issue of considerable importance in the administration of the income tax law."

We invite the attention of the Court to the following sequence of events:

June 21, 1946. The Court of Appeals for the Second Circuit decided *Fairfield S. S. Corp.* v. *Commissioner,* 157 F. 2d 321. The decision was in favor of the Government. The taxpayer filed a petition in this Court seeking a writ of certiorari alleging that the decision below was in conflict with *Court Holding Company* (No. 565, October Term, 1946). The Government opposed the granting of the writ with the statement, "this distinction is one of factual pattern, however, rather than of applicable principles" (Brief of the Respondent in Opposition, pp. 10-11). Certiorari was denied, 329 U. S. 774.

May 12, 1947. The Court of Appeals for the Tenth Circuit decided *Wichita Terminal Elevator Co.* v. *Commissioner,* 162 F. 2d 513. This decision was in favor of the Government.

June 4, 1947. The Court of Appeals for the Fifth Circuit decided *Howell Turpentine Co.* v. *Commissioner,* 162 F. 2d 319. Here the decision was for the taxpayer. Evidently the Government did not see evi-

dence of such conflict and confusion as would raise "an issue of considerable importance in the administration of the income tax law," for it did not seek a writ of certiorari.

December 1, 1947. The Court of Claims decided *Benjamin Guinness* v. *United States,* 73 F. Supp. 119. This was a decision in favor of the Government. The taxpayer filed a petition in this Court seeking a writ of certiorari (No. 696, October Term, 1947) asserting conflict with decisions of other courts and questions "important in the administration of the internal revenue laws." The Government opposed the petition and stated, "* * * there should be no occasion for this Court to re-examine the decision merely because a different result was reached under different facts in *Howell Turpentine Co.* v. *Commissioner,* 162 F. 2d 319 (CCA 5) and *United States* v. *Cummins Distilleries Corp.,* 166 F. 2d 17 (CCA 6), relied upon by petitioner" (Brief of the United States in Opposition, p. 15). Certiorari was denied, 334 U. S. 819.

February 6, 1948. The Court of Appeals for the Sixth Circuit decided *United States* v. *Cummins Distilleries Corp.,* 166 F. 2d 17. This was a decision for the taxpayer. The Government apparently saw no such conflict or confusion as would raise "an issue of considerable importance in the administration of the income tax law," for it did not seek a writ of certiorari in this Court.

February 24, 1948. The United States District Court for the Southern District of Illinois decided *Baum* v. *Dallman,* 76 F. Supp. 410. This was a de-

cision for the taxpayer. The Government apparently saw none of the conflict or confusion which it now claims to be so serious and alarming, because it paid the taxpayer's judgment in full with interest, not bothering either to appeal or to compromise.

April 26, 1949. The Court of Appeals for the Third Circuit decided *Kaufmann* v. *Commissioner,* 175 F. 2d 28. This was a decision in favor of the Government. The time allowed for the filing of a petition in this Court for a writ of certiorari expired three months after April 26, 1949, or on July 26, 1949. The time allowed for the filing of a petition for a writ of certiorari in our case expired on August 2, 1949. Observe with what care the Government delayed the filing of its petition in our case until July 28, 1949, at which time it was too late for the taxpayer in the Kaufmann case to file a similar petition. Obviously if the Government had filed its petition in our case while similar action was still open to the taxpayer in the Kaufmann case, that taxpayer would have been encouraged to seek a review upon the same grounds and the Government would then once again have been in the embarrassing position of contending that the Court of Claims' decision shakes the foundation of tax administration while apparently conflicting decisions (as in the case of *Fairfield S. S. Corp.* and *Benjamin Guinness, supra*) do not.

The Government has shown an astonishing ambidexterity.

We respectfully submit that the actions of the Government in similar cases since the decision of

Court Holding Company do not delineate the Government in the character of a fatherly friend of the Court brooding with anxiety over the future course of tax administration, but rather portray the Government in the light of the ordinary litigant seeking to pick up a dollar wherever and under whatever circumstances it may be found.

(3) There is no real conflict in principle among the decisions of the lower courts.

In the *Court Holding Company* case, this Court said that "the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant." An examination of the decisions cited by the Government as being in conflict with each other and with *Court Holding Company* will disclose that in each instance the Court followed the above-quoted rule, viewed the transaction as a whole, considered each step from beginning to end as disclosed by the evidence, and rested the decision upon the conclusion thus reached. The factual situation is different in each case just as the people involved are different people. In one case the finders of the facts may be warranted in their belief that the true facts are as the evidence shows them to be; whereas in another case the finders of the facts may be satisfied from all of the circumstances that there has been a fraudulent effort to evade, as distinguished from an honest and legitimate plan to avoid.

The decision of the Court of Appeals for the Third Circuit in *Kaufmann* v. *Commissioner*, 175 F. 2d 28, is clearly distinguishable in that the negotiations in that case were conducted by one who was an officer of the corporation but neither a stockholder nor a director. This person did not testify as to whether he was acting for the corporation or for the stockholders and there was no other evidence in the case to overcome the natural inference that he was acting in the only official capacity which he had at the time—that is, for the corporation as its president. Under the circumstances the Tax Court was authorized (and could naturally be expected) to find, as it did, that the sale was negotiated by the corporation rather than by the stockholders.

When a taxpayer asserts that there is the same conflict in principle which the Government here relies upon, the Government has been quick to point out that the supposed conflict is factual rather than legal.

As we have pointed out earlier in this brief, the Government resisted the taxpayer's petition for a writ of certiorari in *Fairfield S. S. Corp.* by dismissing an alleged conflict as a mere "distinction * * * of factual pattern." Under similar circumstances in *Benjamin Guinness*, the Government said "* * * there should be no occasion for this court to re-examine the decision merely because a different result was reached under different facts in *Howell Turpentine Co.* v. *Commissioner*, 162 F. 2d 319 (C. C. A. 5) and *United States* v. *Cummins Distilleries Corp.*, 166 F. 2d 17 (C. C. A. 6), relied upon by petitioner."

Yet in its petition for a writ of certiorari in this case, the Government complains that the lower courts are making a "factual sport" of *Court Holding Company* (Petition, p. 15).

In concluding its brief in opposition to the petition for a writ of certiorari in *Fairfield S. S. Corp.* v. *Commissioner* (No. 565, October Term, 1946, Brief, p. 14), the Government said "taxpayer does not and cannot assert conflict with any decision of this Court or of any Circuit Court of Appeals."

Courts rightly hold ordinary litigants to reasonable standards of consistency and candor. Courts rightly expect that ordinary litigants will not represent a proposition to be false in one breath and true in the next as may best appear to fit the exigencies of the moment. The Government should be judged by the same standards. Surely the Government will not claim to have forgotten the propositions which it so recently and so successfully urged in this Court.

CONCLUSION.

We may well conclude this brief with a direct quotation of the conclusion of the Government's brief in opposition to the petition for a writ of certiorari in *Benjamin Guinness* v. *United States,* certiorari denied, 334 U. S. 819:

> "The decision below is in accord with this Court's decision in the *Court Holding Company*

case. There is no occasion for further review. The petition should, therefore, be denied."

Respectfully submitted,

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APPENDIX A.

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. • • •

• • • • • • • • •

(26 U. S. C. 1946 ed., Sec. 22.)

TREASURY REGULATIONS 103, promulgated under the Internal Revenue Code:

SEC. 19.22(a)-19. *Sale of capital assets by corporation.*—If property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale, computed as provided in sections 111 to 113, inclusive. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

SEC. 19.22(a)-21. *Gross income of corporation in liquidation.*—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dis-

solution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and section 19.44-5. (See further section 19.52-2.)

APPENDIX B.

DISCUSSION OF THE MERITS.

(1) Counterstatement of the Facts.

In its statement of the case, the Government in some instances has misquoted the facts as they were found by the Court of Claims, and in other instances has artfully omitted findings which are detrimental to its argument and which controlled the Court of Claims' decision.

The taxpayer is a corporation which was engaged in the business of generating electricity and distributing it to retail consumers. At all times material to this case it had 400 shares of stock outstanding, held equally by W. L. McComas and members of his family on the one hand, and E. S. Mayes and members of his family on the other hand (R. 56).

Tri-County Electric Membership Corporation, which will be referred to as "Tri-County," was a cooperative corporation which was organized in 1936 and obtained electrical energy from the Tennessee Valley Authority for distribution. Part of its territory included the area served by the taxpayer. Whenever Tri-County considered the acquisition of substantial additions to its electric distribution systems, it turned to the Rural Electrification Administration, Washington, D. C. (which will be referred to as "REA") for a loan with which to pay the purchase price. REA was accustomed to making such loans to local cooperatives if the REA engineers considered the price to be satisfactory and the investment sound (R. 58).

Soon after Tri-County began operating it became evident to the officers of taxpayer that taxpayer would have either to acquire power from Tennessee Valley Authority or to sell out to Tri-County. The Court of Claims found that "negotiations to that end continued more or less regularly thereafter," but this finding can be understood

correctly only by considering it in its context (R. 58). As late as October, 1939, taxpayer was seeking to purchase electric power from Tennessee Valley Authority (R. 58). Since an effort to acquire new sources of power for distribution is inconsistent with a desire to sell out to a purchaser which already has access to the same source of power, it is apparent that the meaning of the above-quoted finding is that Tri-County was more or less continuously negotiating to purchase the properties of taxpayer but taxpayer, instead of participating in those negotiations, was seeking a new source of power which would enable it to stay in business for itself.

Upon taxpayer's failure to purchase power from TVA, taxpayer inquired of TVA whether a sale of its properties could be effected. Nothing came of this inquiry and there were no further discussions with TVA on this subject. None were shown by the evidence and none were found by the Court of Claims (R. 58-59).

On February 16, 1940, there was a meeting at Murfreesboro, Tennessee, at which representatives of the taxpayer offered to sell all of the outstanding stock of taxpayer. The Government boldly states, "It developed, however, • • • that a sale of the stockholders' stock would not be possible because REA would not finance such a purchase but would only finance Tri-County's acquisition of certain of the taxpayer's property." The Court of Claims did not so find. It found that "representatives of the REA expressed *some doubt* as to whether or not that organization could finance a purchase of the stock of the company, *but the determination of this question was deferred* until the legal representatives of the REA in Washington could be consulted" (R. 60). (The emphasis is ours.)

The legal representatives of the REA were later consulted and it was their conclusion that REA had no legal power to finance a purchase of stock, but this conclusion was not communicated to the taxpayer or to any representative of the taxpayer until May 15, 1940 (R. 61). In the three months which intervened between February 16

and May 15, the parties were seeking to reach an agreement as to price, the legal question being obviously immaterial if no agreement could be reached on this point. During this intervening period, the stockholders adhered to their determination to sell their stock and declined an offer in the sum of $86,750 which they understood to be on that basis. That this is true is disclosed by the findings of fact as reproduced on pages 60 and 61 of the Record, for it is shown (R. 61) that after the legal decision was communicated to taxpayer "Mr. Herring, representing the REA, then made an offer of $104,000 for the physical properties desired."

It is thus apparent that the stockholders of taxpayer negotiated for the sale of their stock and it was not until a legal impediment was found that the prospective purchaser made an offer directly to the corporation.

At this point the taxpayer corporation first came into the picture and it was necessary to decide whether it should accept the offer thus received. In order to have before it an idea of the dollars and cents result, the taxpayer and the stockholders caused tax computations to be made by a firm of accountants. These computations disclosed that there would be a tax liability on the part of the corporation in the event it should sell its physical properties. This tax, which was later paid under protest at the insistence of the Commissioner of Internal Revenue, amounted to approximately $17,000 (R. 57). It should be perfectly obvious that if the corporation had made this sale and had paid the tax the net result to the corporation would have been approximately $87,000, which is almost exactly the same figure which had been turned down by the stockholders at a time when they were trying to sell their stock in a transaction which would not have involved the $17,000 tax. Having considered the prospective tax liability the corporation unqualifiedly refused the offer of $104,000. "After considering the net result to the corporation, the directors of Cumberland Public Service Company have determined that the corporation will not accept

an offer of $104,000 for the transmission and distribution lines" (R. 62).

Simultaneously and in the same letter, W. L. McComas and E. S. Mayes, the two principal stockholders, offered to enter into a contract pursuant to the terms of which they undertook to acquire from taxpayer corporation the properties desired by the prospective purchaser, and thereafter to sell the same to the purchaser for $104,000. This was contingent upon obtaining TVA power on a temporary basis to permit consumers to be served until such time as the proposed transaction could be consummated (R. 62-63).

It was found that arrangements for temporary TVA power could be made and thereafter "the offer of May 31 was accepted by Tri-County" (R. 64). The "offer of May 31" was not an offer on the part of taxpayer corporation to sell its assets but was the offer of McComas and Mayes to acquire the assets and thereafter sell them (R. 62-63). Subsequently, the parties executed a written instrument which clearly discloses on its face that the transaction was one between Tri-County as purchaser and McComas and Mayes as sellers (R. 64-65).

Thereafter, members of the Mayes family transferred their stock to E. S. Mayes as their agent, and members of the McComas family transferred their stock to W. L. McComas as their agent. The corporation was then dissolved, and the transmission and distribution lines were conveyed to McComas and Mayes as the only stockholders of record, as a liquidating dividend, pursuant to proper corporate action. McComas and Mayes, joined by their wives, then conveyed these properties to Tri-County, received the purchase price, and made distribution to the stockholders pursuant to the agency contracts (R. 65-68).

The Commissioner determined deficiencies in the taxpayer's income, declared value excess profits and defense taxes for the calendar year 1940 resulting, in part, from his determination that the property in question had been sold by the corporation and that the resulting gains should

have been included in its taxable income. The asserted deficiencies were paid, taxpayer filed a timely claim for refund, the claim was rejected, and proceedings were instituted in the Court of Claims to recover the tax with interest (R. 57-58). The Court of Claims entered judgment for the taxpayer (R. 77).

(2) Synopsis of Argument on the Merits.

The decision below is right. The Court of Claims did not assume that the ultimate question depends upon who appears to be the formal vendor of the property, as the Government asserts, and did not misinterpret *Court Holding Company*. Instead, the Court of Claims properly distinguished between (a) cases in which, considering all the circumstances, it is apparent that a corporation negotiated for the sale of its property, completed acceptable arrangements, and then attempted to create a record having a different appearance for the purpose of evading a tax liability already incurred; and (b) cases, such as this one, where, upon consideration of all the facts and circumstances, it is apparent that the corporation never intended to sell, never negotiated toward a sale of its properties, and did not in fact sell them.

The decision of the Court of Claims recognizes both *Court Holding Company* and the often affirmed right of a taxpayer "to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits," citing *Gregory* v. *Helvering*, 293 U. S. 465, 469; *United States* v. *Isham*, 17 Wall. 496, 506, and other cases.

These principles are not in conflict, as the Government apparently contends, but may be applied concurrently to the facts of each case. Under the one doctrine, a taxpayer is permitted to survey the various courses before him and to select and follow deliberately, a course which incurs the least possible tax liability or no tax liability at all. Under

the other doctrine, a taxpayer is not permitted to incur a tax liability and then fraudulently seek to evade it.

The distinctions between our case and *Court Holding Company* are clear and obvious. In *Court Holding Company* the corporation initiated the negotiations for the sale, agreed upon every detail, received a down payment in the sum of $1,000, and met with the purchaser to prepare a contract embodying the agreements so reached. At this point the heavy tax liability was discovered and the corporation, seeking to avoid the tax, then attempted to retrace its steps, by dissolving, distributing its property as a liquidating dividend, and permitting the stockholders to convey to the purchaser. The Tax Court found that what appeared to have happened did not actually happen, perhaps a clinching circumstance being that the corporation retained the $1,000 down payment and the stockholders permitted the same to be credited upon the purchase price theretofore agreed upon by the corporation.

Quoting the opinion of the Court of Claims in our case (R. 75-76):

> "These are not the facts here. From the very beginning it was the stockholders who were negotiating for the sale of their stock. There was never any intention that the corporation should make the sale, and even when the REA determined that they could not furnish the money to Tri-County to buy the stock, the stockholders still persisted in their purpose of making the sale themselves, and for this reason they caused a dissolution of the plaintiff company, and the stockholders then in fact made the sale of the physical properties received by them as a liquidating dividend.
>
> "We are of the opinion that the principle first laid down by the Supreme Court in the *Isham* case, 17 Wall. 496, and reiterated in *Superior Oil Co.* v. *Mississippi*, 280 U. S. 390, and in *Gregory* v. *Helvering*, 293 U. S. 465, is still the law. If this principle be applied to the facts of this case, we think it is altogether untenable to say that, although the sale in this case was ostensibly made by the stockholders, it was in fact made by the corporation.

"The view we have taken is the same as that taken by the 5th Circuit Court of Appeals in the case of *Howell Turpentine Co. v. Commissioner*, 162 F. (2d) 319, in which opinions were written by Judge Sibley, and by Judges Hutcheson and Lee, all of whom expressed the opinion that although the avowed purpose is to reduce taxation, nevertheless the stockholders of a corporation may validly contract to dissolve the corporation and to sell the physical assets themselves. See also *Commissioner* v. *Falcon Co.*, 127 F. (2d) 277; *United States* v. *Cummins Distilleries Corp.*, 166 F. (2d) 17; *Acampo Winery & Distilleries, Inc.*, v. *Commissioner*, 7 T. C. 629."

It is submitted that the Court of Claims correctly decided the case on the facts before it.